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MEMORANDUM FOR: David Smith [redacted]
INR/RAA
Department of State

SUBJECT : Brazil's Balance of Payments Outlook for 1975 and Its Economic Implications

In response to your request, our analysis of Brazil's balance of payments prospects for 1975 is attached. This supports and supplements OER's verbal contribution to the NIE draft. Further questions may be addressed to the author, [redacted] Code 143/5541.

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[redacted]
Chief,
Latin America Branch
Office of Economic Research

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Brazil's Balance of Payments Outlook for 1975 and Its Economic Implications

Balance of Payments

1. Brazil's estimated balance of payments for 1974 and 1975 are outlined in Table 1. Estimates for 1975 are set forth as a range from least favorable to most favorable. Essentially, the 1975 estimates are based on (a) the range of expected exports given to Ambassador Crimmins by Finance Minister Simonsen and Central Bank President Lira; and (b) an estimated net capital inflow that assumes, in the first case, that the capital flow will remain at about the current rate or, in the second case, that it will recover to about the rate achieved during the first half of 1974. The main balance of payments components are discussed below and the estimates evaluated as far as available data will allow.

Exports

2. Table 2 outlines exports for 1973 and estimates those for 1974 and 1975. The 1975 estimate takes the mid-point of the Simonsen-Lira range as its starting point. The major export components are estimated as follows:

a. Coffee: Brazil's Minister of Industry and Commerce recently stated that coffee exports in 1974 would reach $900 million, a figure that is consistent with available data. Assuming that Gomes referred to both green and soluble, green bean exports should total about $800 million. Exports next year should improve significantly. If the producing countries adhere to their agreement, Brazil will not be able to increase the volume of its sales greatly but prices should be substantially higher. If the producers fail, Brazil's export volume could rise by about 40%. Prices, however, would likely remain below the 1974 average.

b. Sugar: Brazil probably will export about 2.4 million metric tons in 1974 at an average price around $500 per ton. The average export price for raw sugar probably will be about $450 per metric ton. Although sugar prices are now tending to retreat from their recent highs, prices should average about $1,000 per ton for the rest of the year and are expected to remain well above 1974 levels throughout next year. With some increase in export volume, the value of Brazil's sugar exports in 1975 could well double that of 1974.

c. Soybeans and Soybean Products: Exports of beans and products probably will increase about 20% next year as production is expected to rise from 7.0 million tons to about 8.5 million tons. Soybean prices currently exceed $250

per ton compared to Brazil's average export price estimated at $215 per ton for 1974. Prices are expected to hold up well during 1975 because relatively high corn prices probably will cause some soybean acreage to shift to corn and because vegetable oil stocks are very low.

d. Iron Ore: The volume of iron ore exports has been fairly stable for some months, probably reflecting limitations imposed by the rail lines connecting mines and ports. Consequently, the volume of ore exported next year may increase only moderately. Prices appear to be rising, however, and are expected to be significantly above their 1974 levels.

e. Other Primary Exports: Cotton should recover sharply from the low volume of 1974 and the outlook for tobacco and corn is good. Prospects for other items are uncertain, however, as commodity prices in general are weakening and the outlook for Brazilian agriculture next year is not encouraging.

f. Manufactured and Semi-manufactured Goods: This category was the great success story of 1974 but the boom appears to be weakening rapidly. The value of manufactured and semi-manufactured exports in the first half of this year was over 60% ahead of the same period in 1973. Subsequently, however, the lead diminished steadily and in October exports

in this group probably exceeded October 1973 by only about 15%. Given this trend and the poor outlook for the world economy in 1975, exports of manufactures and semi-manufactures will do well to hold their own next year.

Imports

3. The lower side of the estimated import range is based on Finance Minister Simonsen's figure given to Ambassador Crimmins. The upper end of the range is simply the maximum that can be financed under the favorable export and capital flow assumptions and with no further decline in foreign reserves.

Service Payments

a. Non-factor service payments should decline if imports fall partly because ocean freight and insurance will be lower. Brazilian travel abroad is also likely to be restricted further through credit or other controls. If exports and capital flows allow, higher imports and travel abroad will cause some growth in non-factor service payments.

b. Factor service payments will increase sharply because (1) interest payments abroad will rise about 30% due to foreign debt growth this year, and (2) interest income from abroad will decline by about 20% because of the loss in foreign reserves and probably because of lower interest rates. There will also be some further increase in dividend and profit remittance abroad. Thus (in million of dollars)

	1974	1975
Profits and dividends (net)	-250	-275
Interest	-350	-925
Income	900	725
Payments	-1,250	-1,650
Total factor services	-600	-1,200

Foreign Capital Inflow

5. The basic assumptions underlying the estimates in this section were outlined in paragraph one above. It can be added, however, that the capital inflow probably will exceed the minimum estimate, primarily because of further recovery in the flow of foreign financial credits. Brazil can make further cuts in the minimum repayment period for these loans and will make them if it is necessary. Moreover, some of the drop in new financial credits after mid-1974 was due to borrower rather than lender resistance and there are things that Brazil can do to increase Brazilian interest in borrowing abroad (higher domestic interest rates, complete elimination of the tax or remitted interest, etc).

The Economic Impact of Import Restrictions

6. Even under the favorable case, Brazil's imports could grow only 6% in current prices and probably not at all in real terms. This contrasts sharply with real growth exceeding

20% annually during recent years. The economic impact of such a drastic cut in import growth probably will be cushioned by some decline in raw material prices next year and by the reduction of consumer good imports, which still account for over 10% of total imports. Table 3 outlines the estimated import composition for 1974 and 1975. The estimates for 1975 assume (1) that wheat imports can be reduced by one-fourth because of the record crop that is now being harvested, (2) that other consumer good imports can be cut by so much as two-thirds, (3) that petroleum prices will remain unchanged, (4) that prices for the raw material and intermediate good category will remain fairly stable as lower raw material prices offset higher prices for semi-manufactures and component parts, and (5) that prices for consumer goods (other than wheat) and for capital goods will increase 10-15 percent (about the rate of inflation expected in the developed countries).

7. Import restrictions will fall chiefly on the industrial and transportation sectors. Most of the fertilizers and other inputs required by agriculture in 1975 probably will be imported before the end of 1974. Requirements for imported petroleum could remain unchanged next year because of slower economic growth, further increases in gasoline prices, and a probably 20% increase in domestic oil production.

Industrial requirements for imported raw materials and intermediate goods will be reduced somewhat by continuing import substitution and, for a time at least, by drawing on surplus inventories accumulated during 1974. Moreover, the impact of restricted imports will be quite small for Brazil's traditional consumer good industries which operate primarily on domestically supplied raw materials. Consequently, even under the least favorable case in which imports of industrial materials do not grow at all, some expansion of industrial output could still take place. Under the most favorable case, industrial growth probably could approach the 10% increase estimated for raw materials and intermediate goods.

8. The economy's total growth will depend considerably on the success or failure of agriculture and the outlook in this sector is not encouraging. Much of the large growth in farm output achieved this year was due to the recovery of coffee production from the frost damaged 1973 crop. Little or no increase in coffee production is expected next year, however. Surveys of crop prospects in the central south indicate only moderate acreage increases for most crops and drought in the region probably hampered spring planting in some areas. Gains in soybean and wheat production next year almost certainly will be lower than the large increases registered in 1974. Finally, over the

past year, the Brazilian farmer's costs have increased faster than the prices received for his crops and this shift probably has reduced his ability and willingness to increase applications of fertilizers and other inputs. In general, it seems certain that agricultural output will fall considerably short of the 8-9 percent growth reached in 1974.

9. The above consideration indicate why official estimates of Brazils 1975 economic growth range between 5 and 8 percent. The upper end of the range appears reasonable enough but the lower side is questionable. If agriculture has a bad year and balance of payments constraints are severe enough, growth could well fall below 5%. A main chance estimate probably would project growth at 5-6 percent.

Brazils Credit Position Abroad

10. Brazils foreign credit position deteriorated sharply in 1974 as measured by its net debt to export ratio. Both the Brazilian government and the international banking community have watched this ratio closely as a major indicator of Brazils credit standing. In 1967, just before the economic boom began, net debt (total debt less foreign reserves) was nearly double the level of exports. Subsequently the ratio declined steadily as both reserves and exports grew more rapidly than debt. By 1973, net debt

was slightly lower than exports (see table 4). The ratio rose in 1974, however, as debt continued to accumulate rapidly and reserves fell. Even with stringent import restrictions next year, it seems almost certain that the ratio will continue to rise. Both the government and Brazils foreign creditors will watch this trend with considerable concern and it seems likely that tight import controls will be needed beyond 1975 in order to hold the debt level within a reasonable relationship to reserves and exports.

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Table 1

Estimated Balance of Payments, 1974-75

Million US $

	1974	1975 Least Favorable	1975 Most Favorable
Exports (f.o.b.)	7,300	9,000	9,500
Imports (f.o.b.)	-12,000	-11,500	-12,700
Trade balance	- 4,700	- 2,500	- 3,200
Services			
Non-factor services	- 1,400	- 1,300	-1,600
Factor service payments	- 600	- 1,200	-1,200
Total services	- 2,000	- 2,500	-2,800
Total current account	- 6,700	- 5,000	-6,000
Capital (net)			
Direct investment	1,000	1,000	1,000
Official & suppliers credits	900	1,000	1,000
Financial credit	3,300	2,500	4,000
Total capital	5,200	4,500	6,000
Net change in short term capital (-=increase)			
Official reserves	1,200	500	0
Other	300	negl.	0
Total short term capital	1,500	500	0

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Table 2

Exports: 1973 and Estimated 1974-75

Million US $ (f.o.b.)

	1973	1974	1975
Coffee (green beans)	1,243	800	1,000
Sugar	553	1,200	2,400
Soybeans and products	917	900	1,250
Iron ore	363	500	600
Other commodities and raw materials	1,184	1,100	1,200
Total basic products	4,260	4,500	6,450
Manufactures and semi-manufactures	1,940	2,800	2,800
Total exports	6,200	7,300	9,250

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Table 3

Estimated Composition of Imports 1974-75

Million US $ (f.o.b.)

	1974	1975 Current Price		1975 1974 Prices	
		Least Favorable	Most Favorable	Least Favorable	Most Favorable
Total	12,000	11,500	12,700	11,000	12,100
Consumer goods	1,500	700	850	675	800
Wheat	600	400	400	400	400
Other	900	300	450	275	400
Raw materials and intermediate goods	6,700	6,700	7,300	6,700	7,300
Petroleum	2,400	2,400	2,550	2,400	2,550
Other	4,300	4,300	4,750	4,300	4,750
Capital goods	3,800	4,100	4,550	3,625	4,000

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Table 4

Net Debt to Export Ratio
1967-1974 to Projected 1975

Million US $

	Gross Foreign Debt	Foreign Exchange Reserves	Net Debt	Exports	Net Debt/Exports
1967	3,372	198	3,174	1,654	1.92
1968	3,780	357	3,423	1,881	1.82
1969	4,403	650	3,753	2,331	1.61
1970	5,295	1,187	4,108	2,739	1.50
1971	6,622	1,723	4,899	2,904	1.69
1972	9,521	4,183	5,338	3,991	1.34
1973	12,572	6,417	6,155	6,199	.99
1974	16,775	5,200	11,575	7,300	1.59
1975 1/	21,025	4,950	16,075	9,250	1.75

1. Projection for 1975 based on the mid-point of the estimated balance of payments range.

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